CLWYD PENSION FUND COMMITTEE
11 FEBRUARY 2020

Minutes of the meeting of the Clwyd Pension Fund Committee of Flintshire County Council, held at County Hall, Mold at 9.30am on Tuesday, 11 February 2020.

PRESENT: Councillor Haydn Bateman (Vice Chair in the Chair)
Councillors: Ralph Small, Billy Mullin, Kevin Hughes, Adele Davies-Cooke – joined at item 99.

CO-OPTED MEMBERS: Councillor Nigel Williams (Wrexham County Borough Council), Councillor Andrew Rutherford (Other Scheme Employer Representative), and Mr Steve Hibbert (Scheme Member Representative) – up to item 103.

ALSO PRESENT (AS OBSERVERS): Mr Phil Pumford (PFB Scheme Member Representative), Elaine Williams (PFB Scheme Member Representative).

APOLOGY: Councillor Huw Llewellyn Jones.

IN ATTENDANCE:
Advisory Panel comprising: Colin Everett (Chief Executive) – up to item 101, Philip Latham (Head of Clwyd Pension Fund), Gary Ferguson (Corporate Finance Manager), Karen McWilliam (Independent Adviser – Aon), Kieran Harkin (Fund Investment Consultant – Mercer), Paul Middleman (Fund Actuary – Mercer).

Officers/Advisers comprising: Debbie Fielder (Deputy Head of the Clwyd Pension Fund), Karen Williams (Pensions Administration Manager), Nick Buckland (Fund Investment Consultant – Mercer), Nick Page (Risk Advisor – Mercer), Megan Fellowes (Actuarial Analyst – Mercer - taking minutes), Ieuan Hughes (Graduate Investment Trainee).

It was confirmed that Cllr Bateman would be fulfilling the role of Chairman for the next three months ahead of the Council's AGM.

97. DECLARATIONS OF INTEREST (including conflicts of interest)

Mrs McWilliam referred to the reference to the upcoming tenders for the Investment Consultant and Independent Governance advisor roles in the Governance Update (agenda item 8) and noted Aon will obviously be submitting a tender for one of those contracts and that if there are any discussions on this she will leave the meeting for that part of the meeting. Mercer also noted the equivalent interest.

There were no other declarations of interest.

98. MINUTES – 28 NOVEMBER 2019

On page 10, Mr Hibbert queried whether the issue of Scheme Member Representation had been considered at the WPP JGC meeting in January. Mrs Fielder said that there was a JGC meeting in December but no one from the

Fund was represented and there was no meeting in January. The next JGC meeting is in March where it is expected that JGC Scheme Member Representation will be on the agenda.

Mrs McWilliam noted the reference to the GMP rectification exercise on page 11 and stated that this exercise will now continue through to at least June 2020.

The minutes of the meeting of the Committee held on 28 November 2019 were then agreed.

RESOLVED:

The minutes of 28 November 2019 were received, approved and signed by the Chairman.

99. INVESTMENT STRATEGY STATEMENT AND RESPONSIBLE INVESTMENT POLICY

Mr Buckland and Mr Latham took the Committee through the latest Investment Strategy Statement (ISS) and noted the following key points:-

- The regulations requiring funds to produce an ISS were made in 2016.
- The first ISS was required to be published by 31 March 2017.
- These regulations are still in place; however new regulations are due later in 2020. As a result, the ISS may need to be further amended.
- Statutory guidance states that Fund policies on investment cannot go against Government policy.
- There are a number of key requirements for inclusion in an ISS and Mr Buckland highlighted these, including diversification of investments and consideration of risk.

Mr Latham highlighted the changes that had been made to the ISS.

The first change was to include a new Funding and investment's objective at bottom of page 4 of the ISS in relation to the pooling of assets through WPP. The Committee agreed the proposed wording.

Cllr Williams asked whether the Supreme Court case involving the Palestine Solidarity Campaign and Government policy would inhibit the Fund's Responsible Investment policy. Mr Buckland responded that the way in which the Responsible Investment policy has been written, his view is there is no conflict. He said that the bigger issue is that some Funds have disinvested due to certain ethical beliefs. Mr Buckland said that we await the results of the court case and will return to this issue, which should be known over the next few months.

Mr Everett asked why the two asset classes, agriculture and timber, were included within the ISS, and not categories such as renewable energy. Mr Harkin explained that infrastructure as an asset class covers a range of investments including renewable energy. He agreed to revisit the categories.

The Chairman queried how the Fund's benchmark is determined. Mr Buckland said that the benchmark is a composite of all of the benchmarks of the Fund's underlying asset classes. For example, equities and private markets will both have a benchmark, adding these all together determines the Fund's overall benchmark.

Mr Latham added that there are strategic ranges set out on page 12 of the ISS. He noted that a conditional range is used when there are major risks to the Fund, in which case the officers, taking account of advice from the Fund's Investment Consultants, can make decisions that move the asset allocations beyond the strategic range, into the conditional range. Mrs McWilliam asked whether the conditional range had been used before. Mr Latham confirmed that he couldn't recall an extreme situation, but it has been used when the Fund was going through a transition.

Mrs McWilliam suggested to soften the wording on page 21 of the ISS. The wording stated;

In the longer term, subject to the above mentioned objectives being met, the Clwyd Fund is committed to investing all of its assets through the WPP.

Mrs McWilliam proposed that the wording should be closer aligned to the pooling objective on page 4 of the ISS. Mr Everett backed this suggestion and the Committee agreed this wording should be modified in the final ISS.

The ISS states that the Fund will achieve the target weight in three years. Mrs McWilliam asked from when i.e. what year this will be invested. Mr Buckland referred Mrs McWilliam to the document which stated that it is between 2020 – 2023.

Mrs McWilliam highlighted to the Committee that she had some minor changes to feed into the ISS. The Committee approved the revised Investment Strategy Statement subject to minor changes being made by officers, including the points discussed.

RESOLVED:

The Committee noted, commented on and approved the revised Investment Strategy Statement subject to the agreed changes being made.

100. ACTUARIAL VALUATION UPDATE AND FUNDING STRATEGY STATEMENT

Mr Middleman noted that at the September meeting the draft Funding Strategy Statement (FSS) had been discussed and the consultation with employers went ahead in November (including the AJCM and meetings with individual employers) with comments being invited. There had been no material changes to that draft but there had been some minor changes as a result of the discussions with employers and also due to lack of progress on certain national issues and structural changes.

Mr Middleman updated the Committee on the state of play on the consultations on the 4-year valuation cycle and Fair Deal which were due to introduce protected status for members and a Deemed Employer route. There has not been any response to the 4-year valuation consultation and the Fair Deal consultation has not been progressed. It is not envisaged that either of these will be progressed before the FSS needs to be signed off so the related wording has been removed from the FSS. These will be reinserted as required and brought back to Committee once there is an update from those consultations.

Mr Middleman made the following key points;

- When Mercer set assumptions, in particular around inflation, Mercer look at the best estimate of RPI from market yields on Government Bonds. Mercer then estimate CPI inflation (the increases applied to liabilities) by deducting 1% p.a. from RPI (i.e. an RPI-CPI gap of 1% p.a.).
- Following the proposed change in RPI to be more like CPIH, in the September 2019 announcement, the market implied RPI inflation had shifted. Whilst this does not affect the assumptions at the valuation date (31 March 2019) it is important that the Fund recognise this update in the FSS. If this wasn't recognised it would result in using an assumption for CPI (based on the current RPI / CPI gap) which is too low and hence undervaluing liabilities in future calculations. It was noted this will be discussed in more detail in the next item but the proposal is to reduce the RPI to CPI gap to 0.7% p.a. to compensate for this. The consultation on the change is expected as part of the Budget on 11 March 2020 and the position will be kept under review.
- The overall funding level was 91% at the valuation date, with a deficit of £175m.
- The ongoing cost of benefits as a result of the valuation was 17.3% of pensionable pay.
- Contribution rates for employers will be implemented on this basis from 1 April 2020.

On page 25, the Chairman asked why the average deficit recovery period increased from 12 years in the draft FSS to 13 years. Mr Middleman noted this was an average and that different employers (including the Councils) had different periods appropriate to their circumstances and most had reduced by 3 years but 2 Unitary Councils had reduced by 2 years. It was also noted that it is the overall set of parameters that matter i.e. other assumptions like the discount rate are perhaps more important. Furthermore, there have been in-depth discussions regarding this, the affordability of contributions overall and including allowance for McCloud costs. There needs to be a balance agreed when setting a funding plan because it has to be fair to all tax payers (current and future generations) and given that the recovery period for the Fund was relatively short, Mr Middleman was comfortable overall that this is a fair position. Mr Everett added that it was decided to extend Flintshire County Council's recovery period by a year in order to help balance the budgets, which he believes is a reasonable step that was agreed with the Actuary after a well-informed period of discussion.

In respect of the McCloud judgment, Mr Middleman noted that a key part of the setting the strategy is whether to allow or not allow for the potential costs of the McCloud ruling in the contributions paid to the Fund. As the employers had decided to include it directly (as opposed to considering it a budget risk in the future) this gave more credence to concluding the deficit recovery period was fair.

Mrs McWilliam queried why the link between RPI and CPI was not listed as one of the risks in the ISS. Mr Middleman said that it is a structural change but no real difference from any other change to inflation (which was covered). Mercer do not know how it will manifest yet, but whilst there is no harm in including it explicitly in the ISS they do not believe it is required at this point.

RESOLVED:

(a) The Committee noted the report and activity since the September 2019 meeting and consultation; and

(b) The Committee approved the final Funding Strategy Statement.

101. FUNDING, FLIGHTPATH AND RISK MANAGEMENT FRAMEWORK UPDATE

Mr Page introduced himself to the Board and presented the flightpath introductory training session. Further detailed sessions will be scheduled to deliver more detail on the various elements. The presentation covered the main objectives of the flightpath and the following key points were made:-

- The aim of the investment strategy is to deliver a return above inflation, CPI inflation in particular, given that the Fund's liabilities rise with inflation.
- Higher returns above inflation means that lower employer contributions are required to make good on the benefits for members. Conversely lower returns above inflation would mean higher contribution requirements for employers.
- In order to generate return, risk must be taken. However, there is a need to find a balance between taking enough risk to ensure contributions are affordable, but not too much risk that may result in losses on the investments leading to higher contributions in the future. The overarching objective is to be fair to current and future taxpayers by getting this reasonable balance.
- The aim of the flightpath strategy is to manage investment risks to improve the affordability and stability of employer contributions.
- The flightpath is a risk management approach rather than a de-risking mechanism, and works in tandem with the Fund's well diversified investment strategy.
- The flightpath seeks to manage (i.e. hedge) risks associated with both the assets and the liabilities. However, it does not manage all investment or liability risks; rather there is an assessment of whether the benefit of managing a particular risk outweighs the cost of doing so. Cost considerations relate to manager and consulting fees, transaction costs, initial and ongoing governance requirements and the overall impact and likelihood of a risk manifesting negatively so the overall objective is not met.
- The Fund's biggest risk is rising inflation, given that members' benefits i.e. the Fund liabilities, are linked to inflation. This is managed through a Liability Driven Investment (LDI) strategy which aims to maximise the certainty of returns above inflation when market opportunities arise thought a yield-based trigger mechanism. The hedge level was

previously at 20% for interest rates and 40% for inflation. The Fund has decided to reduce inflation exposure by 20% temporarily in light of RPI reform risk which was discussed in more detail after the training.

- The flightpath also manages equity downside risk through an equity protection strategy, and the risk that sterling appreciates, reducing the value of overseas assets in GBP terms, through a currency hedging strategy.
- The flightpath seeks to implement the risk management strategies in an efficient manner. This is evidenced by the collateral "waterfall" approach, which ensures the strategies are supported by enough collateral (essentially a cash like pool of assets backing the hedging framework) but not too much that it acts as a drag on Fund returns. Excess collateral is invested in higher yielding but daily dealing funds in order to generate higher returns but is available for collateral to maintain the hedging position if required at short notice in a low governance manner.
- The flightpath operates through a series of quarterly Funding and Risk Management Group (FRMG) meetings with advisors and officers, monthly and quarterly reporting, and daily monitoring of funding level and market triggers. This allows for opportunities to be identified and the Committee has delegated powers to the Head of the Clwyd Pension Fund to action those opportunities in a timely manner.
- As a direct result of implementing the flightpath, the deficit is £250m better off (all other things equal) since its inception in 2014, which equates to c£15m-£20m p.a. in contribution savings for employers. This is clearly a significant positive impact for the Fund and its employers.

Mrs McWilliam asked how the LDI is managing both liability risks on slide 6. Mr Page confirmed that it looks at both inflation and interest rates, which together provide a yield/return over inflation with a high degree of certainty. This links to the primary objective for the Fund which is to achieve returns above inflation with increasing certainty to provide affordability and stability of employer contributions. Mr Page clarified it is important that this takes place at the right time as otherwise it would be too expensive to achieve certainty. This is why there are triggers in place for when the opportunity arises.

Mrs McWilliam asked whether the Fund should be concerned about being unique in the WPP by having a flightpath strategy. Mr Page confirmed that other LGPS Funds do have similar risk management strategies in place and risk management is an increasing area of focus within the LGPS. Whilst it is not yet on the agenda for WPP to offer a portfolio that can incorporate such a strategy, Brunel have appointed a risk management provider similar to what the Clwyd Pension Fund has in place.

Mr Middleman noted that not every risk management idea that is considered is implemented. Rather, a risk is assessed and if deemed to be material, a range of options are considered on how it should be managed. Mr Everett welcomed further detail on the range of options in relation to decision making to help provide some further context for the Committee in future.

Due to the proposed reform by the government to abolish RPI, Mr Page confirmed that the plan was to align what is currently RPI to CPIH in the future, which is similar to CPI but includes housing costs such as changes to council tax rates. From a liability perspective, there will be no impact as the liabilities are CPI linked which is not changing. Mr Page noted that RPI is currently around 1% p.a. higher than CPIH, and the Fund's inflation hedging assets which are all linked to RPI would fall in value under reforms. Mr Page estimated that the worst-case scenario is that the impact could be a c£100m increase in deficit.

At the FRMG it was discussed at length whether, due to this potential change, the inflation hedging assets should be restructured. It was concluded that on balance there should be a reduction in the inflation hedge ratio from 40% to 20% as a result to mitigate this risk ahead of the consultation starting on 11 March. The Fund is still exposed to inflation rising and there is also a risk that the reform does not proceed, which is the reasoning behind only reducing half the exposure and not all. Therefore, the £100m increase in deficit stated above would now be £50m in the worst-case scenarios modelled. Mr Page confirmed that longer term, the Fund should seek to return back to the 40% inflation hedge ratio once the outcome of the consultation was clearer. The consultation will run from 11 March 2020 for 6 weeks and the Chancellor has committed to a response on this by July 2020.

The Chairman asked whether there is any allowance for housing costs in CPI. Mr Page confirmed that it is not included in CPI but is included in CPIH. CPIH is the UK's national statistic for inflation even though it is not well used or known.

The Chairman queried whether the consultation on government tax relief is due to come in. Mr Middleman said that he would be surprised if it did at this Budget but there could be a consultation announced on the issue given the sources of finance needed by the Government. The Committee will be updated in due course on any issues arising.

Mr Page added that at 31 December 2019, the approximate funding level was 94%, the equity protection had made a £38m gain since inception, and the currency hedging had made a gain of £9m since inception.

The report was noted and no further questions were asked.

RESOLVED:

(a) The Committee noted this report on the various elements of the Risk Management Framework, equity protection and currency hedging strategy; and

(b) The Committee were made aware of the risk from potential RPI reform and the balanced action taken to reduce this risk as well as the costs.

102. POOLING INVESTMENTS IN WALES

Mr Latham gave an overview of the report which demonstrated the progress of the WPP. Paragraph 1.08 illustrates the provision of an emerging market equity sub fund through the WPP and the asset allocation for the Clwyd Pension Fund increasing from 6% to 10% (or £200m). Mr Latham and Mrs Fielder are due to represent the Committee and this matter at the next OWG.

Mr Latham asked for the views of the Committee as to whether the proposed private markets sub-group should have a separate portfolio for impact investing given there is a specific allocation with the Clwyd Pension Fund's investment strategy. Mr Latham explained that the two proposed priority areas for the WPP private markets impact sub-fund are affordable housing and climate change. One of the areas the Fund could ask to be included are the economic areas, looking at SME’s to invest in to hopefully create jobs in the local area.

Mr Hibbert stated that he was not content with the phrase “affordable housing”. He strongly believed that there needed to be a specific reference to the need for a social element within that. Cllr Williams agreed strongly that a different and clearer definition is required.

Cllr Mullin asked whether the areas for inclusion could be extended if these materialise as time goes on. Mr Latham confirmed that they can be added to and extended.

The Committee concluded that they were supportive of climate change elements, supportive of affordable housing subject to the definition being expanded to ensure this included a social requirement, and that they would ideally like the portfolio to include a local element focussed on the Welsh economic generation. Mr Latham agreed that he would feed the Committee's wishes back to the WPP.

RESOLVED:

(a) The Committee noted the report; and

(b) The Committee discussed the creation of an impact fund and priority investments.

103. GOVERNANCE UPDATE

Mr Latham said that there was a Scheme Advisory Board meeting on 3 February but there are no formal meeting notes published yet.

Mr Latham highlighted the key change to the Governance Policy which is the inclusion of an objective focussed on data security and cybercrime; this was shown on page 141 - *Ensuring confidentiality, integrity and accessibility of the Fund's data, systems and services is protected and preserved.*

Mr Latham reminded the Committee about completing their self-assessment forms, and added that Mrs Fielder had hard copies available to complete if that was the preferred option.

Cllr Hughes attended the two day LGA Governance Conference on 23 and 24 January. He highlighted it was a very useful event with lots of discussion about McCloud but there had been no explanation of the background which would have been helpful.

Mrs Williams gave a brief overview explaining that McCloud is an age discrimination case and there was a ruling relating to the firefighters and judicial pension schemes which said younger people put in the new schemes, would now be worse off. People complained that this was ageist and it was upheld so the case needed to be remedied. The Government agreed this needed to be considered for all public sector schemes including the LGPS.

For the LGPS it is likely that the Fund will need to implement a remedy which involving checking which is the better of the old and new schemes for certain members, given that this was the approach provided to all members who were active on 1 April 2012 and within 10 years of retirement. This may be extended to all members who were active at 1 April 2012 irrespective of age. Whilst this has a potential to increase funding costs (as discussed in an earlier item) it is likely to have a much more material impact on the administration, due to the need to recalculate benefits for many members who have left or retired since 2012.

It also affects employers as the Fund will need to gather part time hour changes from employers from April 2014, which will then have to be updated on the Fund's administration system. Mrs Williams explained that, even though the remedy is not likely to be implemented until 2022 at the earliest, the administration team will go ahead with updating the systems so that it will be up to date and the team are prepared. They are expected to them have to and recalculate historical benefits and make payments accordingly (to existing pensioners).

Cllr Rutherford suggested that the two-day conference could have been completed in one day and he also agreed with Cllr Hughes regarding the clarity on McCloud. Mrs McWilliam suggested that further training on McCloud could be provided on the 18 March training day that has been scheduled for the Committee and Board. The Committee welcomed that opportunity for further training.

Mrs McWilliam highlighted to the Committee that there is a Local Authority Responsible Investment Seminar on 8 July in Hertfordshire.

RESOLVED:

(a) The Committee considered the update and provided comments. The Committee agreed to return their self-assessment training needs analysis forms by 19 February as referred to in paragraph in 1.07 of the report; and

(b) The Committee approved the Governance Policy and Compliance Statement, including the new objective relating to cybercrime, referred to in paragraph 1.06 of the report and attached in Appendix 2.

104. ADMINISTRATION AND COMMUNICATIONS UPDATE

Mrs William presented the report. She highlighted that each month the team report on legal requirements for the Key Performance Indicators (KPIs) and each KPI will have a timescale which the team have to legally adhere to. Currently, the Fund provide KPI requirements for 7 processes in the Fund including retirements and death etc. The team monitor how long it takes to report from reciting member information to implementing it, however, sometimes it is the member who is in control of this i.e. it takes them weeks to respond. Mrs Williams highlighted the importance of gathering the Committee's ideas and views for other KPIs to assess and this is something that will be developed over time.

The Chairman asked about resourcing and whether extra staffing is required. Mrs Williams said that if things remained the same then the staff would be fine but because there have been recent updates in regulations and court case announcements that has led to the team being required to complete additional work to support this. This means the resourcing and workflow management will need to be closely monitored.

RESOLVED:

The Committee considered the update and provided comments.

105. INVESTMENT AND FUNDING UPDATE

Mrs Fielder gave a brief investment and funding update and made the following key points:-

- She understood that the business plan priorities for 2019/20 were near completion with most of the tasks on target to be completed before the end of the year.
- Following the results of the valuation, many of the funding and investment risks on the risk register had been reduced in overall relative value and in some cases at target levels.

The report was noted and no further questions were asked.

RESOLVED:

The Committee considered and noted this report for delegated responsibilities.

106. ECONOMIC UPDATE, INVESTMENT STRATEGY AND MANAGER SUMMARY

Mr Harkin gave an update on the recent outbreak in the coronavirus and what it means in context of a pension fund. He said that markets had seen significant falls in China and emerging markets initially, however markets had since recovered. The impact in immediate terms on the bond and equity markets were subject to sentiment. He stated that if there are real severe falls in markets, the Fund has protection through the cash and risk management framework. Mr Harkin then emphasised that the biggest question is whether there is a big economic lag effect i.e. how many countries rely on China to build and buy things for them around manufacturing, for example Apple, and therefore there could be a wider impact such as on the US stock market.

He added that the Fund value tipped over £2 billion at the end of December. The Fund is going through some changes in the investment strategy and implementing them and are in a healthy position despite market volatility.

The report was noted and no further questions were asked.

RESOLVED:

(a) The Committee discussed and commented on the Market and Economic update for the quarter ended 31 December 2019, which effectively sets the scene for the Investment Strategy and Manager Performance summary; and

(b) The Committee discussed and commented on the Investment Strategy and Manager Performance summary for the quarter ended 31 December 2019.

The Chairman thanked everyone for their attendance and updates at the Committee meeting. The next formal Committee meeting is on 18th March along with the training sessions following that meeting. The meeting finished at 1pm.

……………………………………

Chairman